

University of Michigan Journal of Law Reform

Volume 8

1975

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Recommended Citation

Ronald Henry, *Preferential Property Tax Treatment of Farmland and Open Space Under Michigan Law*, 8 U. MICH. J. L. REFORM 428 (1975).

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PREFERENTIAL PROPERTY TAX TREATMENT OF FARM- LAND AND OPEN SPACE UNDER MICHIGAN LAW

As thousands of acres are daily converted from open space or farm use to more intensive uses,¹ Americans are slowly gaining an appreciation of the finite nature of land resources. Among the problems created by continuing urban sprawl are loss of land available for food production and loss of the aesthetic benefits derived from having open spaces readily accessible to residents of the urban area.²

Often cited as a factor contributing to the high rate of conversion to higher use is the *ad valorem* property tax.³ As the city pushes outward, land values on the fringe rise.⁴ Consequently, the land is reassessed to reflect its new potential urban use. Simultaneously, the outward push raises the demand for governmental services, such as police and sanitation, and may thereby force tax rates upward.⁵ With both the tax base and the rate paid on that base increased, the land owner's tax bill rises dramatically while income from his low intensity use (farming is the most common example) rises more slowly, if at all.

In response, the legislatures of more than half of the states have acted to reduce the *ad valorem* property tax burden on farmers,

¹ See, e.g., estimates contained in OFFICE OF LAND USE, MICHIGAN DEPT OF NATURAL RESOURCES, WORKING PAPER, LAND TAXATION AND MICHIGAN 1 (1974) [hereinafter cited as LAND TAXATION], and in CAL. ASSEMBLY INTERIM COMMITTEE ON REVENUE AND TAXATION, TAXATION OF PROPERTY IN CALIFORNIA, A MAJOR TAX STUDY, part 5, at 207 (1964) [hereinafter cited as MAJOR TAX STUDY].

² See Henke, *Preferential Property Tax Treatment for Farmland*, 53 ORE. L. REV. 117, 118-119 (1974). For some of the socio-economic problems associated with urban sprawl, see MAJOR TAX STUDY, *supra* note 1, at 209-14. See also Stocker, *How Should We Tax Farmland In the Rural-Urban Fringe?*, 54 PROC. NAT. TAX ASSOC. 463 (1961).

³ See, e.g., Henke, *supra* note 2, at 119. It is estimated that in Michigan in 1971, property taxes levied on farm real estate amounted to 27.9 percent of net farm income. LAND TAXATION, *supra* note 1, at 1.

⁴ Land, *Unraveling the Rurban Fringe: A Proposal for the Implementation of Proposition Three*, 19 HASTINGS L. J. 421, 428 (1968).

⁵ MAJOR TAX STUDY, *supra* note 1, at 205.

and some states have included tax relief to the owners of open space.⁶ Michigan was added to the list with the passage of the Farmland and Open Space Preservation Act of 1974.⁷ The common underlying theory appears to be that if rising costs, including taxes, are a cause of the sale and conversion to more intensive use, then lower taxes ought to reduce the rate of conversion.

Proposals for the preservation of farm land and open space are, of course, not limited to granting preferences within the *ad valorem* system. Other proposals (aside from public acquisition of the fee) which have been widely considered, but are beyond the scope of this note, include (1) land value taxation⁸ (encouraging the most intensive development of small units of land and avoiding urban sprawl by taxing only the value of the land and not the improvements on it); (2) capital gains taxation⁹ (deterring land speculation by the near total taxation of certain real estate capital gains); (3) development rights transfer¹⁰ (allowing owners in a zoned area to trade the rights to make improvements); and (4) strengthening the resistance to zoning changes.¹¹

Despite this proliferation of ideas, there is no firm consensus on the ultimate wisdom of any governmental intervention to prevent conversion of farmland and open spaces to more intensive uses. Critics and commentators line up on both sides of the controversy. Those who favor some sort of government action argue: that rapid destruction of the country's agricultural base is occurring; that *ad valorem* property taxation is unfair to farmers and open space

⁶ A recent compilation is contained in Henke, *supra* note 2, at 117-118 n.1. A tax break is often more palatable to voters and legislators than is a positive program of subsidy payments even though both approaches have the identical effect of reducing funds available for other projects and even though tax preferences are usually less precise in the selection of benefit recipients than are positive payments programs. Stone, *Tax Incentives as a Solution to Urban Problems*, 10 W. & M. L. REV. 647 (1969).

⁷ MICH. COMP. LAWS ANN. §§ 554.701-.719 (West's 1974 Mich. Legis. Serv. No. 2 at 265-75) [hereinafter cited without source].

⁸ See Lindholm, *Land Taxation and Economic Development*, 41 LAND ECON. 121 (1965); Smith, *Land Value Versus Real Property Taxation: A Case Study Comparison*, 46 LAND ECON. 305 (1970).

⁹ See Barlowe, Ahl, and Bachman, *Use Value Legislation in the United States*, 49 LAND ECON. 206, 212 (1973); Cooke & Power, *Preferential Assessment of Agricultural Land*, 47 FLA. B. J. 636, 641 (1973).

¹⁰ Costonis, *Development Rights Transfer: An Exploratory Essay*, 83 YALE L. J. 75 (1973); Rose, *A Proposal for the Separation and Marketability of Development Rights as a Technique to Preserve Open Space*, 51 J. URBAN LAW 461 (1974).

¹¹ See Note, *The Dilemma of Preserving Open Space: How to Make Californians an Offer They Can't Refuse*, 13 SANTA CLARA LAW. 284, 300 (1972).

property owners both in terms of ability to pay and in benefits received; that the most profitable use is not necessarily the most socially desirable use; and that rising taxes force the farmer off the land before it is fully "ripened," causing the farmer to lose his capital gain to a middleman speculator or causing the land to be prematurely developed in other than the highest and best use.¹²

Opponents of governmental "interference" argue: that subsidies distort resource allocation, preserving inefficiency;¹³ that it alters the input mix of farming operations favoring the land-intensive over labor- or machine-intensive farming;¹⁴ and that it raises land prices by removing a cost of land ownership, thereby creating a windfall to landowners at taxpayer expense.¹⁵ Other critics claim that preserving certain lands simply forces developers to reach farther out, "leapfrogging" the subsidized land,¹⁶ that such skip development creates a checkerboard pattern that raises the costs of city services which now must traverse greater distances,¹⁷ and that the checkerboard enclaves become even more inefficient because their activities (e.g., crop dusting) must be curtailed in deference to nearby populations.¹⁸

This note will not attempt to resolve all of these opposing contentions. Rather, assuming that a rational legislative choice has been made, the note will attempt to explain the new Michigan statute and evaluate the effectiveness of this type of legislation as a means of preserving open space and farmland from conversion to more intensive use.

I. THE NATURE OF PREFERENTIAL PROPERTY TAX TREATMENT

While there are wide variations among the many preferential treatment statutes enacted around the country, most fall into three

¹² See, e.g., Stocker, *supra* note 2.

¹³ Cooke & Power, *supra* note 9 at 639.

¹⁴ See Lockner & Kim, *Circuit-Breakers on Farm-Property-Tax Overload: A Case Study*, 26 NAT'L. TAX J. 233, 238 (1973).

¹⁵ Cooke & Power, *supra* note 9, at 640.

¹⁶ Fusfeld & Kowalski, *Reforming the Michigan Property Tax*, 49 MICH. ST. B. J. 13, 21 (1970).

¹⁷ Note, *supra* note 11, at 296.

¹⁸ Alden & Shockro, *Preferential Assessment of Agricultural Lands: Preservation or Discrimination?*, 42 S. CAL. L. REV. 59, 68 (1969).

broad, overlapping groups.¹⁹ Some states require the assessor to disregard market value and assess the land at its value as used.²⁰ Others provide for deferred taxation by charging a lower-than-normal rate while the land is used in an approved manner and recapturing all or part of the reduction when the land is converted to another use.²¹ A third group provides tax benefits only when the land has been subjected to an enforceable agreement between the owner and the state whereby the use of the land is restricted.²² Obviously a statute may adopt a combination of characteristics. Many states, for example, combine use valuation with tax deferral.²³

II. THE FARMLAND AND OPEN SPACE PRESERVATION ACT OF 1974

A. Antecedents

Farmers and other large land owners have long promoted property tax relief.²⁴ Their success in many states in the past decade appears to be the result of several recent trends, including: the growth of local governmental activity, resulting in higher tax rates; the decline of the local assessor's practice of undervaluing rural land;²⁵ and the realization on the part of urban dwellers of the need to preserve open space.²⁶

In Michigan, the earliest effort toward preferential treatment appears to have been the proposal in 1965 of use-value assessment.²⁷ Since then, preferential treatment proposals have regularly appeared in the legislature. Final passage of the current law came in May, 1974.²⁸

¹⁹ For a somewhat more detailed classification, see Barlowe, *supra* note 9. For a synopsis of the content of each of the statutes, see Note, *Property Taxation of Agricultural and Open Space Land*, 8 HARV. J. LEGISLATION 158, 192 (1970) (Appendix). For a discussion of constitutional requirements, see Hagman, *Open Space Planning and Property Taxation Some Suggestions*, 1964 WIS. L. REV. 628, 640-45.

²⁰ *E.g.*, FLA. STAT. ANN. § 193.461 (Supp. 1973).

²¹ *E.g.*, MINN. STAT. ANN. § 273.111, .112, .13 (Supp. 1973).

²² *E.g.*, CAL. GOV'T CODE §§ 51230-51295 (West Supp. 1973); CAL. REV. AND TAX CODE §§ 421-431 (West Supp. 1973).

²³ *E.g.*, MD. ANN. CODE art. 81, § 19(b) (Supp. 1973).

²⁴ See Hagman, *supra* note 19, at 632.

²⁵ W. WHYTE, *THE LAST LANDSCAPE*, 103-04 (1968). But see Fusfeld & Kowalski, *supra* note 16, who argue that state equalization programs have failed and that underassessment of rural land continues.

²⁶ Hagman, *supra* note 19, at 636.

²⁷ LAND TAXATION, *supra* note 1, Appendix B.

²⁸ Approved by Governor Milliken as the *Farmland and Open Space Preservation Act*, Public Act 116 of 1974, 77th Mich. Legis., Reg. Sess., on May 23, 1974.

B. General Provisions of the Michigan Statute

The statute provides tax relief for owners of farmland and certain open space in return for entry into an agreement with the state or local government restricting the right to develop the land for a minimum period of ten years. Publicized as a combination of agricultural relief and environmental preservation,²⁹ the statute is, despite its open-space provisions, primarily of benefit to individuals and corporations presently engaged in active farming. As discussed below, the Farmland Agreement is the heart and bulk of the statute.³⁰ In effect, three programs are created.³¹ A Farmland Development Rights Agreement (hereinafter referred to as Farmland Agreement) provides income tax credits to farmers who pay excessive property taxes.³² An owner of certain designated open space lands may apply for a Designated Open Space Development Rights Easement (hereinafter referred to as Designated Area Easement) which entitles the owner to a property tax reduction with the state reimbursing the locality for lost revenue.³³ Finally, an owner of open space not within the designated categories may apply to the local governing body for a Local Open Space De-

²⁹ See, e.g., Detroit Free Press, May 8, 1974, at 3-A, col. 4.

³⁰ The original estimates projected an annual \$6-10 million cost for the Farmland Agreement program and \$100,000 for the Open Space program. MICH. HOUSE OF REP. BILL ANALYSIS DIVISION, ANALYSIS - H. B. 4244 (7-17-74) at 2. Preceding enactment, revisions favoring farmland were made that could raise the cost of the Farmland Agreement program to \$94 million annually. Detroit Free Press, May 8, 1974, at 3-A, col. 4.

³¹ The Act uses the word "agreement" in one program, MICH. COMP. LAWS § 554.705, and the word "easement" in the other two, MICH. COMP. LAWS §§ 554.706, .707. The use of this wording was apparently meant only to separate the farmland program from the open space program in order to ensure that the different application procedures and methods of providing benefits would not be confused. In sections describing the effect of the restriction entered into, the words agreement and easement are used interchangeably. See MICH. COMP. LAWS §§ 554.703, .704, .708, .709, .711, .715. However, the definitions section distinguishes agreements, MICH. COMP. LAWS § 554.702(4) ("the owner and the state . . . agree to hold jointly the right to develop"), from easements, MICH. COMP. LAWS § 554.702(5) ("the owner relinquishes to the public . . . the right to develop"). If a court interpreting the statute concludes that the Legislature was not making a substantive distinction but merely using different terms for convenience, it is unclear whether the court should apply property or contract rules. What, for example, will be the effect of changed conditions?

³² MICH. COMP. LAWS §§ 554.705, .710. See notes 35-71 and accompanying text *infra*.

³³ MICH. COMP. LAWS § 554.706. See notes 72-91 and accompanying text *infra*.

velopment Rights Easement (hereinafter referred to as Local Easement) which entitles the owner to a property tax reduction but for which the locality is usually not reimbursed by the state.³⁴ While there are significant differences in the three programs, there is also substantial overlap. The section that follows illustrates the general operation of the Act by describing the Farmland Agreement, including the features common to the other programs. Later sections of the note will focus on the aspects of the two types of open space easements which distinguish them from the Farmland Agreement.

1. *The Farmland Agreement* — Benefits are available to owners of "farmland." While the definition of farmland is ambiguous in several respects,³⁵ an operation devoted primarily to agricultural use involving more than forty acres, or else more than five acres with a gross annual income of more than \$200 per acre, is generally eligible farmland.³⁶

An owner who desires to enter a Farmland Agreement³⁷ begins by filing an application with the local governing body.³⁸ The local government notifies other interested governments and agencies which then have thirty days to file comments and recommendations.³⁹ The local government has forty-five days from receipt of the application to approve or reject it.⁴⁰ If approved, or if

³⁴ MICH. COMP. LAWS § 554.707. See notes 92-112 and accompanying text *infra*. In the case of land that qualifies under two or more of the programs, for example, grazing land that is both farmland and open space, the statute contains no language prohibiting the owner from electing the most advantageous program. For that matter, there is no prohibition against entering more than one program simultaneously. Benefits are structured so that no double subsidy is possible, but under varying circumstances, one program may be more beneficial than the other, and entry to both would effectively permit choice of the superior benefit in any given year.

³⁵ "Farmland" includes "specialty farms," MICH. COMP. LAWS § 554.702(6)(C), and noncontiguous areas which are integrated parts of a farming operation, MICH. COMP. LAWS § 554.702(6)(D). The State Land Use Agency — that is, the Office of Land Use in the Department of Natural Resources, MICH. COMP. LAWS § 554.702(17) — is responsible for promulgating rules and regulations for the implementation of the Act, MICH. COMP. LAWS § 554.717. The ultimate interpretation of the rule defining "Specialty Farms," Proposed Rule 554.701(8), will shape the purposes to which the Act will be put. Thus, as more intensive uses, such as feed lots or mushroom barns, are defined as eligible specialty farms, the effect of the Act shifts toward simple subsidy of agricultural businesses and away from preservation of open space.

³⁶ MICH. COMP. LAWS § 554.702(6), Proposed Rule 554.721.

³⁷ MICH. COMP. LAWS § 554.705.

³⁸ MICH. COMP. LAWS § 554.705(1), Proposed Rule 554.731. The appropriate local governing body may be a city council, township board, or county board of commissioners, depending upon the location of the land. MICH. COMP. LAWS § 554.702(7).

³⁹ MICH. COMP. LAWS § 554.705(3), Proposed Rule 554.732(3).

⁴⁰ This decision is to be governed by rules promulgated by the State Land Use Agency, MICH. COMP. LAWS §§ 554.705(4), .717. These rules are contained in Proposed Rule 554.733(1).

the owner wishes to appeal a rejection, the application is forwarded to the State Land Use Agency (SLUA). If the application was approved by the local governing body, the SLUA may reject it only if the land does not satisfy the definition of farmland.⁴¹ The SLUA may override a local rejection.⁴² If rejected by the SLUA, the applicant may appeal under the Administrative Procedures Act.⁴³

After approval, a Farmland Agreement is executed and recorded.⁴⁴ The Farmland Agreement is a restrictive covenant, for a term of at least ten years,⁴⁵ running with the land, by which the owner and the state jointly hold the right to develop the land.⁴⁶ The land so restricted may not have built upon it any structure or improvement except for use consistent with farm operations.⁴⁷ The owner may not sell any interest in the land except an easement which does not substantially hinder farming operations (*e.g.*, one for access or for utilities).⁴⁸ The whole of the owner's interest in the land may, however, be sold without penalty if the successor in title complies with the terms of the Farmland Agreement.⁴⁹ If the owner or successor in title converts land covered by a Farmland Agreement to a prohibited use or knowingly sells for a prohibited use, he may be enjoined and is subject to civil liability for damages.⁵⁰

⁴¹ MICH. COMP. LAWS § 554.705(7), Proposed Rule 554.733(2). Since the state pays for the benefits conferred under a Farmland Agreement, *see* notes 51-61 and accompanying text *infra*, this limitation effectively allows the locality to commit the state to substantial expenditures. Moreover, since there is no cost to the locality, except for the exemption from special assessments described in notes 60 and 61 and accompanying text *infra*, applications will likely be routinely approved as a service to residents, and the Act will serve merely to provide a subsidy to any interested farmer, without regard to open space values of the subsidized land. The proposed rules do not limit the local government's ability to approve applications beyond requiring that the broad definition of "farmland" be satisfied. Proposed Rule 554.733(1).

⁴² MICH. COMP. LAWS § 554.705(6).

⁴³ MICH. COMP. LAWS § 554.705(9). Appeal is pursuant to Public Act 306 of 1969, MICH. COMP. LAWS § 24.201 *et seq.*

⁴⁴ MICH. COMP. LAWS § 554.705(8).

⁴⁵ MICH. COMP. LAWS § 554.704(1).

⁴⁶ MICH. COMP. LAWS § 554.702(4).

⁴⁷ MICH. COMP. LAWS §§ 554.705(7)(a), (b).

⁴⁸ MICH. COMP. LAWS § 554.705(7)(c). However, under MICH. COMP. LAWS § 554.704, the Farmland Agreement does not supersede any interest or lien previously recorded. Such interests may be inconsistent with the purposes of the Farmland Agreement. For example, the statute is silent about mineral rights which are often held by other than the possessor of the surface. Apparently a locally approved Farmland Agreement must be granted by the state even though someone has the right to come in at any time and begin mining operations. *See* text accompanying note 41 *supra*.

⁴⁹ MICH. COMP. LAWS § 554.711.

⁵⁰ MICH. COMP. LAWS § 554.715.

In return for accepting these restrictions, the owner *may* receive a tax benefit from the state. Land approved for a Farmland Agreement is assessed at its fair market value by the State Tax Commission.⁵¹ The land is not exempted from local taxation. Rather, the owner calculates the amount by which property tax on land covered by the Farmland Agreement exceeds 7 percent of household income⁵² (or taxable income in the case of corporate owners⁵³) and receives a credit in that amount on his state income tax liability.⁵⁴ If the credit exceeds state income tax liability, the owner receives the difference in a payment from the state.⁵⁵ The

⁵¹ MICH. COMP. LAWS § 554.705(7). This initial state assessment provides a base from which the state can judge later whether the locality is yielding to the temptation to over-assess the land knowing that the state, not the owner, will pick up the tax bill. For a description of the benefit mechanism, *see* text accompanying notes 52-61 *infra*. The Act does not, however, mention the possibility of state review and rollback of local assessments. It is unclear whether such mechanisms could be adopted as part of the administrative rules. The Proposed Rules, 554.737(2), do require the locality to inform the SLUA annually of the current assessment.

⁵² MICH. COMP. LAWS § 554.710(1)(a). "Household income" includes all income of all members of the household. MICH. COMP. LAWS § 206.508(4). "Income" is roughly equivalent to gross income as defined by the Internal Revenue Code. INT. REV. CODE OF 1954, § 61; MICH. COMP. LAWS § 206.510(1). The rationale behind the 7 percent figure is unclear. Perhaps it is the level at which the tax burden becomes "excessive," but if excessive burden is the concern, then considerations of income level or ability to pay may have been overlooked. Moreover, all farms, even those in areas that will not be threatened with development in the foreseeable future, are eligible. Although it is beyond the scope of this note, it would be useful to analyze income and tax burdens in areas removed from development pressures. Perhaps property taxes exceed 7 percent of household income even in the most remote areas. In that event, preserving adequate supplies of farmland from conversion would be of secondary import in a program of general subsidy to farmers.

This problem has arisen in other states as well. *See, e.g.*, Note, 13 SANTA CLARA LAW., *supra* note 11, at 291, noting that much of the subsidized land in California is in no danger of conversion. *See* Henke, *supra* note 2, at 124; Lockner & Kim, *supra* note 14.

⁵³ MICH. COMP. LAWS § 554.710(1)(b). The corporate owner stands to benefit from the Act even more than does the individual owner. Household income, MICH. COMP. LAWS § 206.508(4) (Supp. 1974), the base for the individual, includes income attributable to the farmer's services in running the farm, INT. REV. CODE OF 1954, § 61, MICH. COMP. LAWS § (Supp. 1974). Corporate taxable income, MICH. COMP. LAWS 206.510(1) §§ 206.28,.32 (Supp. 1974) does not include payments for services. For example, assume two farms, one individually owned, the other incorporated, with identical operations and revenue, each operated by a single farmer. The corporate farm may deduct its expenses, including the salary paid to the resident farmer, in determining taxable income. INT. REV. CODE OF 1954, §§ 162,63. The individual farmer will have all of the same deductions except salary, since the compensation from services he renders is income to him and is therefore included in household income. Consequently, although identical in all other respects, the base for determining whether taxes exceed 7 percent is higher for the individual than for the corporation.

⁵⁴ MICH. COMP. LAWS § 554.710.

⁵⁵ MICH. COMP. LAWS § 554.710(3).

calculation is based on the whole of household income, though only part of an owner's holdings are in the program and though the owner receives only a part of his income from the land. Consequently, the subsidy is linked less to the land as an incentive to keep it in farm use than to the individual farmer's need for income support.⁵⁶

Another limitation on the receipt of benefits is that tax credits are available only to owners.⁵⁷ Owners are defined in the Act as persons having a freehold interest coupled with possession and enjoyment.⁵⁸ Apparently, then, a lessor or lessee may not avail himself of the program.⁵⁹

An additional benefit is partial exemption from special local assessments (*e.g.*, for sewers).⁶⁰ The land so exempted may not make use of the improvement paid for by the special assessment until the special assessment is paid and the Farmland Agreement is terminated.⁶¹

Termination of the Farmland Agreement may occur by one of three routes. Termination in the public interest, at the request of the state and with the agreement of the owner, occurs without penalty.⁶² Presumably, even if the owner does not agree to the

⁵⁶ MICH. COMP. LAWS § 554.710(1)(a). It may be that the use of total household or taxable income was meant to deter the professional speculator whose holdings will include more than farmland. While this scheme will be effective in that respect, if the goal of the statute is income subsidy through tax relief for farmers, this restriction is overbroad because it will exclude many of the most needy. The farmer whose property tax is high in relation to his farm income may be forced to take a second job because his farm is small and poor. The second job raises total household income, thereby reducing the percentage of household income taken by property taxes and denying the marginal farmer, who is most likely to sell, any benefits.

⁵⁷ MICH. COMP. LAWS § 554.710. Beneficiaries of an estate or trust, partners, and participants in subchapter S corporations, INT. REV. CODE OF 1954, § 1371 *et seq.*, are entitled to a proportionate share of the credit, MICH. COMP. LAWS § 554.710(1)(c), apparently on the theory that the one who pays the tax on the farm income should get the tax credit.

⁵⁸ MICH. COMP. LAWS § 554.702(9).

⁵⁹ Presumably the limitation is meant to avoid the abuses occurring in other states where speculators buy land for development but, until the land fully appreciates in value, lease it to tenant farmers whose presence may activate the subsidies and whose efforts generate sufficient income to cover the remainder of the speculators' carrying costs. W. WHYTE, *supra* note 25, at 109-10; Lockner & Kim, *supra* note 14, at 239. Nevertheless, it is difficult to justify, either in terms of income subsidy or preservation of farmland, a distinction between bona fide farmers based on the form of possession of the land.

⁶⁰ MICH. COMP. LAWS § 554.709.

⁶¹ MICH. COMP. LAWS § 554.709.

⁶² MICH. COMP. LAWS § 554.712(2) (a), (6). The Act contains no express grant of authority to any agency or officer of the state to determine the public interest, nor does it provide any standard for the determination. Proposed Rule 554.701(9) provides that "State" means a major State agency in agreement with the SLUA. *See* note 63 and notes 108-112 and accompanying text *infra*, for discussion of intra- and inter-governmental conflicts.

termination, the state power of eminent domain is unaffected.⁶³ State interests which would not justify taking by eminent domain, however, must apparently yield to the continuing validity of the Farmland Agreement. Thus, a state determination that the land should be privately developed in the public interest is insufficient, without the owner's consent, to terminate the agreement and end the tax benefit.⁶⁴

If the Farmland Agreement terminates naturally — that is, if the term of years expires — then a lien for the last seven years' tax benefits, without interest or penalty, attaches.⁶⁵ Prior to natural

⁶³ The statute is unenlightening if not contradictory. MICH. COMP. LAWS § 554.716 requires other state agencies to inform the SLUA of activities which might jeopardize the preservation of land contemplated by the Act. This could be construed to mean that the SLUA is to be notified of prospective uses of the eminent domain power in order that the SLUA could more rationally decide those cases in which it has discretion to reject an application. Yet, the provision includes the requirement that the SLUA notify other agencies of land covered by agreements or easements and states that, on the basis of such information, the other agencies shall harmonize their projects with the purposes of the Act. This latter requirement appears to limit the exercise of the eminent domain power to those instances consistent with the Act. If construed to mean that the eminent domain power may not be used against land covered by an agreement or easement, state projects, especially in areas with high concentrations of agreement- or easement-covered land, will be severely hampered. If eminent domain may proceed, compensation to the owner is uncertain because the State holds the development rights and may not release them without the consent of the owner. MICH. COMP. LAWS §§ 554.704(2), .712(2)(a), .713(2)(a), .714(2)(a). Since the government holds and is paying for the development rights, arguably any eminent domain compensation representing the development right ought to go to the government, not to the owner. To avoid this danger, the owner will almost certainly agree to terminate.

The more complicated case is where one government agency invokes the eminent domain power and the agency charged with determining when to terminate in the public interest refuses to do so. This may often occur in the case of a Local Easement, created and paid for by the local government. MICH. COMP. LAWS § 554.707. Having invested in the preservation of the land as open space, the locality may not agree that the state exercise of eminent domain is in the public interest or justifies termination. It is unclear whom the state must compensate when it exercises eminent domain over land in which a local government holds development rights.

A similar problem exists as to whether the owner should be required to return benefits he received under the Act before his land was taken by eminent domain. If the holder of the development rights refuses to make a determination that termination is in the public interest, the provisions providing that no penalty shall accrue, MICH. COMP. LAWS §§ 554.712(6), .713(6), and .714(6), will not apply. Since such a taking constitutes a sale known to be for a use prohibited by the agreement or easement without the permission of the holder of the development rights, MICH. COMP. LAWS § 554.715 would seem to impose penalties upon the owner. For a listing of other states' methods of handling analogous problems, see Barlowe, *supra* note 9, at 209.

⁶⁴ MICH. COMP. LAWS § 554.712(2)(a).

⁶⁵ MICH. COMP. LAWS §§ 554.712(1), (7). Under MICH. COMP. LAWS § 554.708, the owner is supposed to notify the state of his future intentions two years before the natural expiration of the agreement or easement. No penalty is provided for failure to notify the state. Compare CAL. GOV'T. CODE § 51244 (Deering 1974), wherein contracts must be made for a ten-year minimum term. At the end of each year, the contract is automatically extended for another year unless the owner notifies the state of his desire to withdraw. Consequently, the contract will not naturally terminate without at least nine years prior notice by the owner. See Olpin, *Preserving Utah's Open Space*, 1973 UTAH L. REV. 164, 186; Mix, *Restricted Use Assessment in California: Can It Fulfill Its Objectives?*, SANTA CLARA LAW. 259 (1971).

termination, the agreement may be terminated at the owner's request, subject to approval of the state.⁶⁶ Approval of an owner's request for termination follows the same procedure as creation of the Farmland Agreement.⁶⁷ The nature of the administratively determined criteria and the placement of the burden for termination will have a bearing on the effect of the Act.⁶⁸ If termination is made so easy that the owner may withdraw from the program practically at will, the state will lose the planning and land-preservation advantages of the enforceable agreement. Furthermore, the owner will have gained flexibility for speculative maneuvers while the state subsidizes the carrying costs of the land for so long as the owner desires and no longer.

Upon approval of an owner's request for termination, a lien attaches, equal to the total amount of benefits received, compounded at 6 percent interest from time conferred until paid.⁶⁹ The lien may be discharged by re-entry into a Farmland Agreement, but any subsequent lien may not be less than the lien discharged.⁷⁰

⁶⁶ MICH. COMP. LAWS § 554.712(2)(b). It is not clear whether the owner may terminate as to only part of the land covered by the agreement, and if so, how the lien recouping the benefits conferred is to be calculated. Most other statutes are equally vague in this area. *See* Barlowe, *supra* note 9, at 209.

⁶⁷ MICH. COMP. LAWS § 554.712(2)(b). *See* text accompanying notes 37-43 *supra*.

⁶⁸ Proposed Rule 554.743 requires consideration of "economic inviability" and changes in the land or its surrounding. The Rule does not prevent approval of a termination request for other reasons.

One set of grounds for termination has been legislatively determined. Under MICH. COMP. LAWS § 554.711(2), the land may be released in the event of death or total, permanent disability of the owner. Liens then attach as in the case of natural termination. *See* discussion in note 65 and accompanying text *supra*.

⁶⁹ MICH. COMP. LAWS § 554.712(4). The lien becomes payable when the land is sold or converted to a use prohibited by the former Farmland Agreement. MICH. COMP. LAWS § 554.712(5).

⁷⁰ MICH. COMP. LAWS § 554.712(5). It is possible that an agreement would run its course and expire, a second Farmland Agreement would be entered into, and, during the life of the second Farmland Agreement, the owner would request and receive permission to terminate. The Act specifies that the lien shall be for "the total amount of the credit . . . received by the owner under MICH. COMP. LAWS § 554.710. MICH. COMP. LAWS § 554.712(4). It is uncertain whether this applies to the total amount derived from all Farmland Agreements under which benefits concerning that land have ever been received or only under the Farmland Agreement currently in effect. If only the benefits from the current Farmland Agreement are recouped, the owner may run the course of one Farmland Agreement, receiving ten years of benefits, enter a second Farmland Agreement, and terminate it after a short time, thereby incurring only a minimal lien.

Therefore, it is important to analyze more closely the transition from the first Farmland Agreement to the second. Under one interpretation, the first Farmland Agreement naturally terminates and a lien for the last seven years of benefits attaches at once. Entry into the second Farmland Agreement then discharges that lien. This solves the problem of minimal penalty for quick termination of the second Farmland Agreement because the second lien may not be less than the previously discharged lien.

Proceeds from lien payments are to be used by the state to purchase development rights on other land.⁷¹

2. *Designated Areas Easements* — Much of the procedure and effect described in the preceding section of Farmland Agreements is equally applicable to the Designated Area Easement. Consequently, this section will simply deal with the ways in which the Designated Areas Easement differs from the Farmland Agreement.

The Designated Areas Easement program is a very limited one,⁷² applying only to historical sites, "Environmental Areas"

However, this interpretation creates difficulties in the case of the Open Space Easements for which no lien discharge provision exists. After a natural termination of the first Open Space Easement, a lien would attach, though the owner entered a second Open Space Easement and though the land was never converted from open space use. Since there is no lien discharge provision, this logic would require imposition of another, cumulative lien upon natural termination of the second Open Space Easement and so on. Consequently, similarly situated owners of farmland and open space who each went through, say, four ten-year covenants with the state would have strikingly different lien liabilities upon natural termination of the fourth covenant.

To avoid these difficulties, better interpretation would treat the transition into the second period not as a natural termination of one agreement and entry into a second, separate agreement, but as an extension of the original agreement for additional years. MICH. COMP. LAWS § 554.712(1) indicates that the state shall relinquish the Farmland Agreement at the expiration of the original agreement *unless renewed*. Thus, if renewed, the state does not relinquish the first agreement and take a second one; it keeps the original which is now enforceable for an additional number of years. This approach is especially appropriate where the owner has performed his duty to notify the state prior to expiration of an agreement of his intention to remain in the program. MICH. COMP. LAWS § 554.708. Under this single, extended Farmland Agreement, no lien would attach until final termination. Ultimately, natural termination would result in a seven-year recoupment, while requested termination would recoup "the total amount of the credit . . . received by the owner," MICH. COMP. LAWS § 554.710, thus solving the problem of termination a short time into the second period.

This latter interpretation is consistent with the goal of discouraging termination in the middle of a contract period. The owner gets benefits for the full contract term, but, more importantly, the state gets the full benefit of the period it contracted for. From the standpoint of state planning and preservation of farmland, the state loses whenever termination by request shortens the period of land use protection.

It should be noted that farmers will still have an incentive to await natural termination and imposition of a seven-year lien followed by re-entry and discharge of the lien in order to reduce the ultimate cumulative recoupment upon a final requested termination. But, since this is the result in all farmland cases under the former interpretation, this second interpretation is preferable because it relieves the open space owner of the burden of additive natural termination liens and more clearly links the farmer's remaining advantage to the lien discharge provision, which only he may utilize.

⁷¹ MICH. COMP. LAWS § 554.712(5). The statute does not specify which agent of the state, if any, is to collect the liens.

⁷² By one estimate, it will apply to only 238 miles of river frontage, 390 miles of shoreland, and a handful of historical sites. Ann Arbor News, May 24, 1974, at p. 8, col. 1.

under the Michigan Shorelands Protection Act, and land within one-quarter mile of certain rivers under the Michigan Natural Rivers Act.⁷³ Application for a Designated Areas Easement follows the same routing as that for a Farmland Agreement.⁷⁴ Application approval differs, however, in that unlike the case of the Farmland Agreement, there is no provision requiring the SLUA to approve every application previously approved by the local governing body and covering land defined in the Act as eligible.⁷⁵ However, the SLUA has eliminated its discretion by establishing rules governing approval and rejection,⁷⁶ which impose the same limitation as exists for Farmland Agreements.⁷⁷

Administrative discretion was in any event somewhat illusory. Each application for a Designated Areas Easement (including those the SLUA rejects)⁷⁸ must be submitted to the legislature, and no application is finally approved except by a resolution approved by a majority of the members elected and serving in each house of the Legislature.⁷⁹ As a consequence of this cumbersome procedure, a Designated Areas Easement, assuming one's land satisfies the narrow eligibility requirements, is considerably more difficult to obtain than is a Farmland Agreement. The difference in procedure points up a difference in purpose. While Farmland Agreements are available as an income subsidy without regard to open space values involved, Designated Areas Easements are available only upon express determination by the Legislature that a particular piece of open space ought to be preserved.

When a Designated Areas Easement is approved, the owner receives a tax exemption. The State Tax Commission conducts a dual appraisal, determining the current fair market value of the land and the fair market value of the development rights.⁸⁰ The fair

⁷³ MICH. COMP. LAWS § 554.702(8)(a). See Michigan Shorelands Protection and Management Act of 1970, MICH. COMP. LAWS §§ 281.631-.645 (Supp. 1974); Michigan Natural River Act of 1970, MICH. COMP. LAWS §§ 281.761-.776 (Supp. 1974).

⁷⁴ See text accompanying notes 37-44 *supra*.

⁷⁵ MICH. COMP. LAWS § 554.706(1), (2).

⁷⁶ MICH. COMP. LAWS §§ 554.705(4), .717 apply to Designated Areas Easements by virtue of MICH. COMP. LAWS § 554.706(1).

⁷⁷ Proposed Rule 554.733(2).

⁷⁸ MICH. COMP. LAWS § 554.706(2). Note that in discussing otherwise identical procedures, MICH. COMP. LAWS § 554.706(2)(e) refers to "each application," while MICH. COMP. LAWS § 554.707(8), dealing with Local Easements, refers to "each approved application." Adding the word "approved" to MICH. COMP. LAWS § 554.706(2)(e) would restore the discretion to SLUA that the other provisions imply. This is probably a drafting error, but it may reflect a legislative judgment that the land eligible for Designated Areas Easements is of sufficient importance to the state to justify legislative review of even the applications rejected by the SLUA. Proposed Rule 554.734(9) ignores the difference in wording and requires only the forwarding to the Legislature of applications approved by the SLUA.

⁷⁹ MICH. COMP. LAWS § 554.706(2)(e).

⁸⁰ MICH. COMP. LAWS § 554.706(2)(e).

market value of the property as a whole less the fair market value the land would have if it could only be used as open space yields the value of the right to develop the land.⁸¹ By the terms of the Designated Areas Easement, the state holds the development rights, and the owner is exempted from the *ad valorem* tax on the portion of the property value representing the development rights.⁸² The state then compensates the local government for revenue lost by virtue of the exemption.⁸³ In return for the benefits conferred, the Designated Areas Easement prohibits building any structure or making any improvement without the state's permission.⁸⁴

Termination in the public interest⁸⁵ and at natural expiration⁸⁶ occurs as with Farmland Agreements.⁸⁷ Termination at the request of the owner follows the same process as the original approval, including the need for legislative approval.⁸⁸ Liens attach for the same penalties as are imposed for the corresponding termination of a Farmland Agreement.⁸⁹ Unlike the Farmland Agreement, there is no provision for discharge of the lien if a new Designated Areas Easement is entered.⁹⁰ Also, unlike Farmland Agreements, pay-

⁸¹ It remains to be seen whether this division of values is feasible. Many states which assess farmland at use-value use the same technique, but farms are more easily comparable than are open space parcels. For example, the value of farmland if restricted to farmland use can be compared to land with similar yields in remote areas where there effectively is no other use than farming. Open space is more difficult to compare because it produces no income and its value depends on a multitude of more subtle aesthetic variables and often unique characteristics.

⁸² MICH. COMP. LAWS § 554.706(3).

⁸³ MICH. COMP. LAWS § 554.706(2)(e).

⁸⁴ MICH. COMP. LAWS § 554.706(2).

⁸⁵ MICH. COMP. LAWS § 554.713(2)(a). Even though legislative approval was required to create the Designated Areas Easement, such approval is probably not required for termination in the public interest. The Act uses the same language, "the state determines," MICH. COMP. LAWS § 554.713(2)(a), as is used for Farmland Agreements, MICH. COMP. LAWS § 554.712(2)(a), and, unlike terminations by request, MICH. COMP. LAWS § 554.713(2)(b), terminations in the public interest do not carry the express requirement that the terminations be processed in the same manner as was the original approval. Proposed Rule 554.747(1) is not explicit, but it appears to support this interpretation.

⁸⁶ MICH. COMP. LAWS § 554.713(1).

⁸⁷ See text accompanying notes 62-68 *supra*.

⁸⁸ MICH. COMP. LAWS § 554.713(2)(b). See text accompanying notes 74-79 *supra*. Proposed Rules 554.741 - .746.

⁸⁹ MICH. COMP. LAWS § 554.713(4) (termination at owner's request); MICH. COMP. LAWS § 554.713(7) (natural termination); MICH. COMP. LAWS § 554.713(6) (termination in the public interest). Note that the recoupment is of *ad valorem* taxes avoided by the owner rather than the income tax credits provided in the case of the Farmland Agreement.

⁹⁰ See note 70 *supra*.

ments of liens received by the state are not committed to specific use. No reason for the distinction is stated.⁹¹

3. *Local Easement* — The fundamental difference between Local Easements and Designated Areas Easements is, as the names used in this note imply, the emphasis on the local nature of the program. Localities may act to protect open space without approval from the state.⁹²

Any area in which preservation as open space would conserve natural or scenic resources may be the subject of a Local Easement.⁹³ As with the Designated Areas Easement,⁹⁴ the owner does not pay *ad valorem* property taxes on the portion of the value that is attributable to the development rights.⁹⁵ Restrictions upon the land are the same as with Designated Areas Easements.⁹⁶

Application begins as with Farmland Agreements and Designated Areas Easements.⁹⁷ Unlike the other programs, no approval beyond that of the local government is necessary.⁹⁸ Along with local control, however, comes local cost. The statute does not provide for state reimbursement of the benefits conferred by the local government.⁹⁹ The loss of revenue may be worthwhile to the locality in terms of increased flexibility of local planning and in the ability to control land use without public purchase of the fee.¹⁰⁰ The bleak financial condition of many local governments, however, may limit the attractiveness of a program which decreases the local tax base.

⁹¹ Perhaps the Legislature viewed liens capturing the Farmland Agreement income tax credit as the receipt of new revenue (and therefore rather like a windfall which is easy to part with for the purchase of land) while viewing the liens recapturing the amounts paid out under Designated Areas Easements as simply a return of state funds to be placed in the treasury like any appropriated but unexpended sum. Benefits under both programs, however, have the identical effect of reducing funds available for other state programs, and the collection of liens under both increases available funds.

⁹² MICH. COMP. LAWS § 554.707(5).

⁹³ MICH. COMP. LAWS § 554.702(8)(b). Idle potential farmland parcels of more than forty acres are also expressly made eligible.

⁹⁴ See text accompanying notes 80-83 *supra*.

⁹⁵ MICH. COMP. LAWS § 554.707(10).

⁹⁶ MICH. COMP. LAWS § 554.707(5). See text accompanying note 84 *supra*.

⁹⁷ MICH. COMP. LAWS §§ 554.707(1) - (4). See text accompanying notes 38-40 *supra*.

⁹⁸ MICH. COMP. LAWS §§ 554.707(5), (6). Note that some state control remains in that the SLUA is to promulgate rules governing approval by the locality. Since the locality is not normally reimbursed for the benefits conferred upon the owner by this program, (see note 100 and accompanying text *infra*), the state has no financial interest in specific applications, and the SLUA-promulgated rules have wisely chosen not to restrict severely the localities' ability to use their own money as they deem best. Proposed Rule 554.733(3).

⁹⁹ MICH. COMP. LAWS § 554.707(10).

¹⁰⁰ After data from the early years of the Act's operation become available, an interesting study might compare the long-term revenue loss with the public purchases which could have been made with the same revenues.

If the local government rejects an application, the owner may appeal to the SLUA.¹⁰¹ If the SLUA approves the application, it is submitted to the legislature for final approval as with Designated Areas Easements.¹⁰² If the Legislature approves an application originally rejected by the local government, the state will reimburse the local government for lost revenue as with Designated Areas Easements.¹⁰³

Idle potential farmland is classed as eligible for a Local Easement rather than for a Farmland Agreement.¹⁰⁴ Since it is expected that Local Easements will be more difficult for an owner to obtain than Farmland Agreements, there is further indication that the primary purpose of the statute is neither to preserve open space nor to assure an adequate future supply of farmland, but to subsidize present farmers. Moreover, the statute may even be counterproductive at the margin in terms of preserving open space. Under the regular *ad valorem* property tax system, the potential from farming may not be sufficient to induce the owner of open space to begin farming it. If, as in the present statute, an easily obtained subsidy for farms is added while it remains difficult to get a subsidy for open space land, the incentive to convert from open space to farm use is increased.

Upon termination, liens attach as with the corresponding types of termination of Farmland Agreements and Designated Areas Easements.¹⁰⁵ Unlike Farmland Agreements, there is no provision for discharge of the lien upon re-entry into a new Local Easement.¹⁰⁶

Termination by natural expiration is the same as with Farmland Agreements.¹⁰⁷ Terminations at the request of the owner and in the

¹⁰¹ MICH. COMP. LAWS §§ 554.707(7), (8).

¹⁰² MICH. COMP. LAWS § 554.707(8). *Compare id.* with Designated Areas Easements, text accompanying note 78 *supra*. Unlike Farmland Agreements, MICH. COMP. LAWS § 554.705(9), and Designated Areas Easements, MICH. COMP. LAWS § 554.706(1), no appeal from a rejection by the SLUA is expressly provided. *See* text accompanying note 43 *supra*. Under the Administrative Procedures Act, MICH. COMP. LAWS § 24.201 *et. seq.* (Supp. 1974), however, appeal may exist as of right for a "contested case."

¹⁰³ MICH. COMP. LAWS § 554.707(8). Consequently, if the local government believes that the state will act, it has nothing to lose and everything to gain by rejecting the application and urging the owner to appeal. *See* Proposed Rule 554.723(2) for factors considered by the SLUA to be important to successful appeal.

¹⁰⁴ MICH. COMP. LAWS § 554.702(8)(b).

¹⁰⁵ MICH. COMP. LAWS §§ 554.714(4), (6), (7). *See* text accompanying notes 65, 69-71 *supra*.

¹⁰⁶ *See* note 70 *supra*.

¹⁰⁷ MICH. COMP. LAW § 554.714(1). *See* note 65 and accompanying text, *supra*.

public interest pose a problem. The statute provides that the local government may approve requests for termination¹⁰⁸ and may determine when to terminate in the public interest.¹⁰⁹ Normally, this scheme makes sense because the locality is providing the tax subsidy without state reimbursement; it should have control over when it will end the subsidy. However, where the local government rejected an application and the state subsequently approved it on appeal, the state does fund the subsidy by reimbursing the local government for lost revenue. Since the state thus has an investment in the land, the state rather than the locality should have control over termination.¹¹⁰ Nevertheless, the statute provides no exception to the general procedure of determination by the local governing body.

To meet this problem, the proposed rules require the SLUA and the legislature to approve termination in the public interest¹¹¹ and requested terminations¹¹² where original approval came through successful appeal of a local rejection. Thus, while a local governing body may create any Local Easement desired, it may terminate only those which it did create; Local Easements created by the legislature may be terminated only by the legislature.

III. THE EFFECTIVENESS OF PREFERENTIAL TAX TREATMENT AS A PRESERVATION MEASURE

Michigan, like many other states enacting preferential property tax legislation, has enacted a broad, voluntary plan.¹¹³ Leaving aside for the moment the question of overinclusion,¹¹⁴ a voluntary

¹⁰⁸ MICH. COMP. LAWS §554.714(2)(b) provides that requests for termination are to be processed by and subject to the procedures governing creation of the Local Easement. Since the local governing body could unilaterally create any Local Easement, presumably it could terminate one though the particular easement were created by the legislature.

¹⁰⁹ MICH. COMP. LAWS § 554.714(2)(a). Similar problems surround the use of eminent domain. See text accompanying note 63 *supra*.

¹¹⁰ This is especially so because the locality receives the lien proceeds and the state therefore recoups nothing upon termination. MICH. COMP. LAWS § 554.714(5).

¹¹¹ Proposed Rule 554.747(3).

¹¹² Proposed Rule 554.743(3).

¹¹³ Perhaps the program need not be voluntary. If a government may tax lands and use the proceeds to buy the development rights to that very land, it should be able to achieve the same result in a single transaction by simply restricting the land and adjusting taxes for what would have been the purchase price of those rights. To the extent that these restrictions constitute a taking, the tax benefits conferred may be seen as the constitutionally required compensation. U.S. CONST. amends. V. XIV. See Note, *supra* note 11, at 301, for a proposal to down-zone drastically certain lands and compensate the owners for the resulting reduction in value.

¹¹⁴ If, as is suspected, the primary goal of the Act is the subsidy of active farmers rather than preservation of open space, it is not an overinclusion to allow entry by farmers whose land is not threatened with development.

plan must delicately balance the need for sufficient incentives to induce a self-interested owner to enter the program and the need to prevent such incentives from becoming a mere windfall to the owner without protecting the land from conversion.¹¹⁵ The goal is to structure incentives and penalties to encourage entry to and discourage exit from the program. The Michigan Act attempts to encourage entry by offering a tax benefit and discourage exit by requiring an enforceable contract and by imposing termination penalties.

The enforceable contract aspect helps to deter speculation by reducing the number of points at which the owner may exit. At the same time, however, an enforceable contract may deter entry by owners of land under the greatest development pressure. For example, a ten-year minimum contract term will deter an owner who expects his property to be saleable in five years at a price exceeding the advantages available by entering the program. Thus, except for those owners who are truly devoted to a *particular* piece of land and who will continue to farm or hold as open space the same land (so long as they are not driven into insolvency by property taxes) without regard to potential gain from the sale of the land, the Michigan Act has only long-term promise.¹¹⁶ Land far from the urban areas may be subjected to restrictions by owners eager to receive present tax benefits. If this land can be locked into the program, it may be preserved from conversion when the urban sprawl finally reaches it.

The Michigan Act defers taxes by reducing them while land is in the program and recouping benefits upon termination. However, deferral of taxes (especially when coupled with partial forgiveness as in the Michigan Act) raises the possibility of simply allowing the financially pressed landowner to become the speculator.¹¹⁷ Formerly forced to sell because of an inability to meet high carrying costs, his taxes are now deferred until he can sell for a good price, pay the back taxes, and still realize a sizeable capital gain on the

¹¹⁵ A tax relief program which fails to demand some form of quid pro quo from the owner, rather than preventing conversion, may actually increase speculation by reducing carrying costs on the speculator's land. See W. WHYTE, *supra* note 25, at 102.

¹¹⁶ Other states' programs are similarly limited. See, e.g., Note, *supra* note 19, at 190; Olpin, *supra* note 65, at 189.

¹¹⁷ For analysis of this potential under the California system, see Mix, *supra* note 65, at 264-68.

transaction. In this situation, land is not protected from conversion to more intensive use; the only effect is to eliminate the middleman speculator.¹¹⁸

The conclusion drawn by studies of the impact of preferential treatment in other states with programs similar to Michigan's is that conversion of land has not been appreciably slowed and, to the contrary, that the programs generally do no more than subsidize the carrying costs of land speculators, be they professionals or individual owners.¹¹⁹

Given the present approach to preferential treatment, there can be no other result. This is demonstrated below by an examination of the possible options open to the individual owner. Aside from the owners who will continue to hold their present land unless and until they are driven to bankruptcy, most landowners may be viewed as rational economic beings.¹²⁰ Land owned has two values: (1) What the owner may derive from holding and using the land, and (2) what the owner may realize by selling it. The owner's decision to hold or sell at any given time depends on which of these values is greater. Adding the possibility of entering the Michigan subsidy program, the landowner now has four options, which can be expressed as four values for each time at which a decision could be made. These values are represented by the four cells, I, II, III, and IV in the figure below.¹²¹

¹¹⁸ See W. WHYTE, *supra* note 25, at 116. This in itself may be of some use to the state. If tax deferral allows the owner to hold the land until it has fully "ripened," some of the helter-skelter development associated with premature sale and conversion may be avoided.

¹¹⁹ See Sullivan, *The Greening of the Taxpayer: The Relationship of Farm Zone Taxation in Oregon to Land Use*, 9 WILLAMETTE L. J. 1 (1973); Note, *supra* note 19, at 171; Note, *supra* note 11, at 295; and Henke, *supra* note 2, at 123-24.

¹²⁰ Thus, the rational farmer "pushed" off the land by rising costs and the rational farmer "pulled" off by large gains on the sale of the land are really equivalent. Rising costs reduce net income, making a given capital gain look better. Rising capital gains means that the net income must also increase or the owner will sell. To prevent conversion, the state must thus subsidize each farm to the point where net income exceeds gain from sale, or the farmer will convert his land to other uses. See also note 121 *infra*.

¹²¹ The framework presented is designed only to demonstrate the basic relationships of the individual's four options and does not pretend to express fully all of the relevant variables. Thus, for example, the taxation differences between sale and use of the land are omitted.

Income is used in the broad sense of all benefit received. Thus, the pleasure of living in a rural atmosphere is a component of income. However, only income derived from the land, not the owner's labor, is included. It is assumed that the income from his farm labor is the same as income from that labor in non-farm work that would be done if the owner disposed of the land and took another job. Thus, the term drops out of all equations. Income from the present time to some future time is the same in all four cells and is also omitted.

FIGURE 1

	LAND IS <u>NOT</u> PLACED IN THE MICHIGAN SUBSIDY PROGRAM	LAND IS <u>PLACED</u> IN THE MICHIGAN SUBSIDY PROGRAM PRIOR TO TIME t
VALUE IF LAND IS RETAINED AT TIME t	Cell I = Capitalized net income from time t forward	Cell III = Capitalized net income from time t forward <i>plus</i> Accumulated benefits to time t <i>plus</i> Capitalized future benefits from time t forward
VALUE IF LAND IS SOLD AT TIME t	Cell II = Amount realizable from sale at time t	Cell IV = Amount realizable from sale at time t <i>plus</i> Accumulated benefits to time t <i>less</i> Lien imposed upon termination of contract

By taking the present value of each of the four cells for any future time, the options may be compared to reveal that which offers the greatest return to the owner.

While one may object that the owner may have neither the desire nor the information to calculate his options far into the future, it is the *state*, not the owner, that must make the calculations. The state must plan now, when the owner enters the program, to structure penalties and incentives so that later, when the owner does begin to consider his options, the subsidies and penalties will indeed have protected the land from conversion.

A. Implications of Tax Preferences

1. *Land that would not have been converted even in the absence of any subsidy* — For some land, there is no time at which the value in Cell II exceeds that in Cell I; that is, at no time does the value of sale exceed the value of retention. For example, land far removed from development pressures may have no value for uses more intensive than farming. Nevertheless, except where entry into the program would result in a zero benefit, the values in Cell III are higher than the values in Cell I at all times. Thus, the owner of land that is economically viable in its present use and who does not need a subsidy is given incentive (and an opportunity under the Michigan Act) to enter the program and receive a subsidy for continuing that use.

2. *Land that will be converted unless subsidized* — If there are points at which Cell II exceeds Cell I, the subsidy must be set at a level high enough to cause Cell III to exceed Cell II; that is, the value of the subsidy must be greater than the difference between the unsubsidized value of retaining the land and the value of selling it. Since in most states, including Michigan, the level of subsidy does not depend on the difference between the values in Cell I and Cell II, the subsidy may not close the gap. For example, the Michigan farmer whose property taxes do not greatly exceed 7 percent of household income may not get a sufficient subsidy to make continued farming more attractive than sale.

3. *Conversion of land that has been subsidized* — The owner will enter the program, receiving a subsidy which reduces carrying costs, and will seek to terminate at a time when the value in Cell IV exceeds that in Cell III.¹²² It does not matter whether the owner

¹²² The ability to terminate at other than natural expiration depends on the liberality of the regulations to be developed by the SLUA. See text accompanying note 68 *supra*. If termination is made easy, the owner gains flexibility to choose the most profitable moment for exit.

recognized this possibility when he entered the program, so long as he later perceives the advantage of leaving the program. In the event of such conversion, the state subsidy has not only acted to defer carrying costs, but, to the extent that the lien imposed is exceeded by the accumulated benefits received, it has also amounted to a windfall upon the owner.¹²³

4. *Sale of land under the program vs. sale of nonsubsidized land* — Since Cell IV is simply Cell II adjusted for the effect of the subsidy and lien, Cell IV equals Cell II when the lien recoups all of the subsidy compounded at the appropriate rate of interest.¹²⁴ Thus, to the extent that the subsidy is not recaptured, entry to the program followed by termination and conversion is made even more attractive than conversion without entry into the program. Therefore, the subsidy must be further increased because Cell III must exceed both Cell II and Cell IV if conversion is to be prevented.¹²⁵

The above relationships indicate that, as presently constituted, the Michigan Act (as well as other states' provisions) subsidizes land that is in no danger of conversion, fails to subsidize land that will be converted unless subsidized, and further fails to prevent the conversion of land that has been subsidized or recapture benefits previously conferred under the program.

B. Needed Action

Unless the value in Cell I exceeds that in Cell II at all times, in which case no entry to the program should be allowed, incentives should be structured to make Cell III the greatest value in order to draw in land that would be converted in the absence of a subsidy

¹²³ Though the land is ultimately developed, governmental planning of development may nevertheless have been aided by the assurance that the land would not be developed while the agreement was in force. Again, the ability of the owner to choose to terminate at other than natural expiration is of critical importance.

¹²⁴ Since the money saved in tax reductions may usually be invested at a rate greater than 6 percent, the rate at which past benefits are compounded for purposes of computing the lien upon termination by request, there is no deterrent to exit even if all of the tax benefits compounded at 6 percent are recouped. Effective benefits conferred will always exceed the recoupment.

¹²⁵ Increasing the Cell III benefits also increases the Cell IV benefits. Assume that IV exceeds III by \$10 and that the lien recoups seven-tenths (seven years out of a ten-year agreement) of any new benefit conferred upon Cell IV. If the benefits to Cells III and IV are increased by \$10 each, the lien recoups only \$7. IV still exceeds III by \$3, and the state must further increase benefits if Cell III is to become the highest value.

and to prevent the terminations that will occur when Cell IV is the highest value.¹²⁶ If Cell IV is held down by increasing penalties, an effective Cell III need only exceed Cell II by the amount of the transaction cost of entering the program.

However, even if the lien fully recaptures the benefits conferred and the appreciation thereon, the program will nonetheless fail (unless the subsidy is increased) where the amount realizable from sale is growing at a faster rate than is the capitalized net income, as in areas of severe development pressure. In these areas, Cell II (which equals Cell IV with full recapture) will at some point surpass Cell III. To remain effective, then, the subsidy must be raised to increase Cell III. Assuming that tax benefits could rise as rapidly as does the amount realizable from sale, not even the state has the resources to subsidize all land in unprofitable use to the extent of the difference between the value of retaining the land and the value of selling it, especially where, as in the urban fringe, the difference is already great and is still growing.

Since the state can not increase benefits to a level where Cell III always exceeds Cell II, the owner will not enter the program where the present value of some future Cell II value exceeds the value of entering the program (Cell III) now if he has sufficient resources to cover the carrying costs of the land until it ripens. The program similarly fails for owners who lack the resources to hold the land until it ripens — that is, owners who will be forced to sell because they can not sustain the expenses of holding the land until it fully appreciates in value. These owners will enter the program because they can not afford to wait until the favorable sale date, but unless Cell III is increased, they will exit through Cell IV when the Cell II value surpasses that of Cell III. This is so because full recapture merely reduces Cell IV to the level of Cell II. By exiting through Cell IV, the owner has the same return and carrying costs as if he had used Cell II, but by entering the program, those carrying costs were deferred until the owner could cover them with the proceeds from sale. The owner has become the speculator.

¹²⁶ Discussions of preferential tax treatment programs generally include the observation that the program must avoid deterrence to entry. The tendency is to focus on termination penalties and to reduce them in an effort to avoid overbalancing the incentives to enter with penalties for termination. This assumes that entry is in fact discouraged by high exit penalties. To the contrary, if Cell III exceeds Cell II, there is incentive to enter the program even if penalties are so high that it is impossible for Cell IV ever to contain the highest value. By creating the possibility that the value in Cell IV could be the highest, the state merely raises the cost to itself of creating an effective value in Cell III.

Eliminating Cell IV as a possible highest value removes the possibility of state subsidy followed by conversion to higher use. It does not, however, permanently tie an owner into the program, since under the Michigan Act, the owner may sell without penalty if the buyer continues the land in its approved use.

For the owner whose land is so remote that it will not ripen for a very long time,¹²⁷ the program can be made into an effective preservation measure. This can not be done by the impossibly expensive route of increasing benefits, but can only be done by increasing termination penalties beyond full recapture. To succeed, the program would, in effect, have to become a trap.

To induce entry, the value in Cell III must initially exceed that in Cell II. If, after entry, termination penalties are structured so that Cell IV is kept below Cell III despite increases in the sale price of the land, conversion will be prevented. For the program to prevent conversion, then, the penalties must be set to lock land into the program, though this may require penalties in excess of the benefits conferred.

IV. CONCLUSION

The Michigan Farmland and Open Space Preservation Act was motivated, at least in part, by a desire to reduce the rate of conversion of finite land resources to intensive use. To achieve this goal, the Legislature used a system of property tax relief available primarily to farmers and only minimally available to open space owners. While the Act contains many gaps, most of these may be filled by judicial and administrative interpretation.

More fundamentally, the Michigan Act, in common with the many similar provisions in other states, fails to look sufficiently far beyond the ready assumption that conversion can be deterred if only the cost of continuing to hold the land is reduced. A subsidy that is not directly linked to the gap between the value of the continued low-intensity use and the value of sale is ineffective. The Act subsidizes land that would not be converted even in the absence of any subsidy, fails to subsidize some land that will be converted unless subsidized, and fails to prevent the conversion of land that has been subsidized. Some owners might keep their land in low-intensity use (refusing to move despite potential economic gain from conversion) until hopelessly insolvent. Assuming that

¹²⁷ That is, for owners of land which will ripen so far in the future that even though the value in Cell II will someday exceed that in Cell III, the present value of that future Cell II date is less than the value of entering Cell III today.

such owners exist, that insolvency would occur without subsidy, and that the Michigan program provides the increment necessary to avoid insolvency, then the program will preserve land. The combination of these three circumstances, however, is likely to be uncommon.

In most cases, the state subsidy is merely an increment to the value of retaining the land in low-intensity use. The state simply can not afford the burden of subsidizing substantial amounts of land to the extent necessary to outweigh the gap between the owner's value of continued low-intensity use and the owner's return from sale for conversion to a higher-intensity use. Aside from imposing heavy termination penalties that are structured to lock owners into the program, a tax preference program such as Michigan's cannot save substantial areas from conversion.

Preservation of our dwindling supplies of farmland and open spaces is a crucial goal that will not be achieved unless methods other than the current forms of tax preferences are used. While the Michigan Farmland and Open Space Preservation Act may be an effective way to provide an income subsidy to farmers, it is a poor approach to fulfilling the goal its name implies.

—*Ronald Henry*